

MANAGEMENT

DISCUSSION AND ANALYSIS

MAJOR DEVELOPMENTS

Strategic partnership with Amcor Group

The Amcor Group has become a substantial shareholder of the Company since January 2005 following the completion of its subscription of 80,000,000 shares of the Company. In December 2005, the Group entered into the sale and purchase agreement for the acquisition of the controlling stakes in two factories of the Amcor Group in Beijing and Qingdao, namely, Beijing Leigh-Mardon Pacific Packaging Co., Ltd. (“Beijing LMPP”) and Qingdao Leigh-Mardon Packaging Co., Ltd. (“Qingdao LMPP”), by way of issuance of 121,200,000 shares of the Company as consideration. The Group also entered into two subscription agreements with the Amcor Group in relation to the subscription of a further 112,670,000 shares of the Company. As a result of the transactions, the Amcor Group would hold 313,870,000 shares, or approximately 44% of the enlarged issued share capital of the Company.

The Board believes that the above transactions would enable the Group to expand its business into the northern part of China, diversify the Group’s revenue base and generate synergies for both the Group and Amcor Group as a result of sharing of resources (such as technological know-how, printing machinery, shared marketing and sales force) as well as the economies of scale. Given the background of Amcor Group as the largest producer of tobacco packaging in the world, the combination of the Group and Amcor Group would create a unique and strategic position in terms of market positioning. Besides, the Group will secure capital and technological support which are necessary to attract high quality and sizeable targets and/or other strategic market participants for further business expansion and consolidation.

Contribution from World Grand

The acquisition of 35% equity interests in World Grand Holdings Limited (“World Grand”) was completed in January 2005. Since then, the Company is entitled to share the profit from World Grand. At that time, World Grand owned 90% equity interests in Kunming World Grand Colour Printing Co., Ltd. (“Kunming World Grand”) which is a key supplier to Hongyun Tobacco Group, being the second largest cigarette manufacturer in the PRC. As mentioned last year, the acquisition has provided a strategic opportunity for the Group to penetrate into the cigarette market in Yunnan Province which is the largest manufacturing bases in the PRC. This strategic relationship has created synergies for both the Group and World Grand in terms of resources sharing and the benefits of economies of scale. It has also provided the Group with a stable demand for laminated papers from Kunming World Grand. As mentioned below, the contribution from World Grand has proved to be a successful investment of the Group.

RESULTS

For the year ended 31 December 2005, the Group continued to achieve significant growth in terms of profit. Turnover during the period increased by approximately 15% to HK\$383.5 million with increase in gross profit margin. Given the significant contribution from the Company’s associated companies, in particular, Kunming World Grand, the profit attributable to the shareholders of the Company increased by approximately 63.6% to HK\$181.3 million.

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BUSINESS REVIEW

The Group is principally engaged in the printing and manufacturing of high quality cigarette packaging and laminated papers in the PRC.

Cigarette Packaging Printing

The cigarette packaging printing business is operated by Victory Honest Industries (Shenzhen) Co., Ltd. ("Victory Shenzhen"), a wholly-owned subsidiary of the Company. Turnover from cigarette packaging printing was increased from HK\$97.7 million to approximately HK\$132.3 million, representing a

production process for high quality laminated paper, i.e. laser laminated paper manufacturing and laser film production, and has commenced the development of transfer paper which is an environmental friendly product encouraged by the government. During the year under review, there was a decrease in the sales of laminated papers to Nanjing Sanlong mainly due to less orders placed by Nanjing Sanlong as well as change in product requirement. However, the decrease in sales to Nanjing Sanlong was offset by the sales of laser laminated papers by the Group. Despite the increase in material costs such as aluminium foils and laser films which are heavily affected by the high oil



growth of approximately 35%. The increase in the turnover of cigarette packaging printing is mainly due to: (i) our shift of emphasis in the product mix to mid-high end products since last year; (ii) the secure of one new sizeable order from Changsa Cigarette Factory which indicates a significant breakthrough into a top five cigarette manufacturer and a new geographical segment; and (iii) the volume growth arising from the increase in production utilization leading to economies of scale.

Laminated Paper Manufacturing

Turnover from laminated paper manufacturing was increased from HK\$234.7 million to approximately HK\$251.2 million, representing a growth of approximately 7%. The Group has been moving upstream to complete the vertical integration of the

price, the gross profit margin of laminated papers has remained stable.

Contribution from associated companies

The profit of the Group is contributed significantly from the two associated companies of the Company, namely Nanjing Sanlong Packaging Co., Ltd. ("Nanjing Sanlong") and World Grand. Nanjing Sanlong is owned as to 48% by the Group. It has established long term and stable relationship with Nanjing Cigarette Factory and Huaiyin Cigarette Factory, which are the key cigarette industry enterprises in Jiangsu Province. Kunming World Grand is owned as to 31.5% by the Group and is a key supplier to Hongyun Tobacco Group, being the second largest cigarette manufacturer in the PRC. Contribution from associated companies was

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increased by approximately 98% to HK\$76.0 million, representing approximately 42% of the total profit attributable to the shareholders of the Company for the year ended 31 December 2005.

The significant increase in the contribution from associated companies was mainly due to the inclusion of the contribution from World Grand after completion of the acquisition in January 2005 as well as the out-performance of World Grand which accounted for approximately 24% of the total profit attributable to the shareholders of the Company for the same year. During the year under review, there was a decrease in the contribution from Nanjing Sanlong of approximately HK\$6 million mainly due to the fact that the market consolidation in Jiangsu Province is yet to happen and the key customers of Nanjing Sanlong, i.e. Nanjing Cigarette Factory and Huaiyin Cigarette Factory, have been changing their product mix, and thereby placed less orders to Nanjing Sanlong, in order to enhance their competitiveness in the market in preparation of the market consolidation.

PROSPECTS

The long-term business objective of the Group is to become the market leader in the industry in the PRC.

As mentioned in the prospectus and previous announcements of the Company, the cigarette manufacturing industry in the PRC is undergoing a consolidation process, as a result of which the number of cigarette manufacturers has been greatly reduced from about 104 in 2001 to about 80 in 2004. It is estimated that there were only about 40 cigarette manufacturers in the PRC at the end of 2005 and each manufacturer usually engages only two to five key cigarette printing companies. The ongoing consolidation of the cigarette industry in the PRC will inevitably affect the competitive landscape and business prospects of cigarette printing companies.

The acquisition of World Grand, Beijing LMPP and Qingdao LMPP has enabled the Group to expand its business into the southern-west and northern part of PRC, diversified the Group's revenue base and generate synergies for the Group, World Grand and Amcor Group as a result of sharing and consolidation of resources (such as technological know-how, printing machinery, shared marketing and sales force). Economies of scale will be achieved and production utilisation and efficiency of various factories of the Group will be further enhanced from the central procurement system and the allocation of resources and orders among the factories. Further growth is expected to come from the synergies arising from the standardization of the production process and the central management reporting system of the Group. The new order secured from Changsa Cigarette Factory has indicated a significant breakthrough of the Group. With the increasing recognition of laser laminated paper from the market and the continuing shift of the Group's emphasis to mid-high end products, it is hoped that the Group will secure more flagship brands from top cigarette manufacturers in the near future and the profit contribution from Victory Shenzhen will be further improved.

In future, the Group will continue to pursue its acquisition strategy for accelerating its growth to become a market leader in the manufacturing of cigarette packaging products in the PRC. In two to three years' time, it is forecast that the number of cigarette manufacturers in the PRC will be further reduced. The Directors believed that the current key customers served by the Group, namely, Etsong Tobacco Group in Shandong Province, Hongyun Tobacco Group in Yunnan Province, Nanjing Cigarette Factory and Huaiyin Cigarette Factory in

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Jiangsu Province, Changsa Cigarette Factory in Hunan Province, and Guangdong Tobacco Group in Guangdong Province will remain as the market players after the consolidation. The Group will also benefit from the background of Amcor Group as its controlling shareholder and the largest producer of tobacco packaging in the world for market positioning to attract high quality and sizeable targets and/or other strategic market participants for further business expansion and consolidation.

In March 2006, the Company announced the proposed acquisition of the remaining equity interests in World Grand. In view of the encouraging results of World Grand, the Directors consider that it is in the interest of the Company and the Shareholders as a whole to hold 100% equity interests in World Grand which would then enable the Company to consolidate its results and obtain absolute control over the management, operations and cashflow of World Grand, thereby further facilitating the centralisation of procurement activities and resources allocation among the production plants of the Group, as mentioned above, with an aim to improving the overall utilisation of the production capacity of the Group.

The Group is confident that it can cope with the challenges amid the changing business environment and will move one step closer to its goal of becoming the leader in manufacturing of cigarette packaging products in the PRC.